November 1, 1982

Application of California Property Tax
to Foreign-Owned Aircraft

In a letter dated September 29, 1982 to of the United States Department of State requested information concerning any state and local taxes which are currently levied on foreign airlines by the State of California. This is in response to your request for a memorandum on the application of property tax to foreign-owned aircraft.

I. <u>Aircraft Owned by a Foreign Government.</u>

Revenue and Taxation Code, Section 5331 exempts aircraft owned by a foreign government from personal property taxation. Thus, aircraft belonging to airlines such as KLM and SAS which are owned by the governments of their respective countries of registry, are automatically exempt from property taxes.

II. <u>Aircraft Owned, Based, and Registered Abroad and Used Exclusively in International Commerce.</u>

Pursuant to both case law and by board rule, aircraft owned, based, and registered abroad and used exclusively in international commerce is exempt from property taxes in California.

In <u>Scandinavian Airlines System, Inc.</u> v. <u>County of Los Angeles</u> (1961) 56 Cal. 2d 11, cert. denied, 368 U.S. 899, the City and County of Los Angeles levied an apportioned ad valorem tax upon airplanes owned by Scandinavian Airlines System. The airplanes operated between Copenhagen, Denmark and Los Angeles. The planes landed in the United States only at Los Angeles International Airport and remained there for less than 34 hours on each flight. The court ruled that ad valorem property tax levied upon aircraft owned, based, and registered abroad and used exclusively in international commerce, was unconstitutional under the commerce clause.

Board Rule 202(b) provides that foreign owned and based aircraft operated solely in foreign commerce do not acquire situs within the state for property tax purposes.

III. Foreign Aircraft Engaged in Interstate Commerce.

The taxability of foreign aircraft also used in interstate commerce is not covered by statute or by board rule. In Japan Lines, Ltd. v. County of Los Angeles (1979) 441 U.S. 434, 60 L. Ed. 2d 336, the United States Supreme Court decided that instrumentalities of commerce that are owned, based, and registered abroad and that are used exclusively in international commerce, cannot be subjected to apportioned ad valorem property taxation by a state. The Court specifically noted that it did not reach the question as to the taxability of foreign owned instrumentalities engaged in interstate commerce. 60 L. Ed. 2d at 345, n. 7. However, this point of law is moot under current F.A.A. and C.A.B. regulations. By F.A.A. and C.A.B. regulation, foreign operators cannot get authority to conduct business in the United States. A foreign carrier may, for example, land at San Francisco International Airport and continue on to New York as part of a continuation of the international flight, but it may not take on additional passengers. This information was confirmed by Mr. Roger Grunert, F.A.A. Western Division Program Manager.

IV. Conclusion.

Aircraft owned by a foreign government is exempt from property tax. Further, foreign owned, based, and registered aircraft used exclusively in international commerce is not taxable in California. Since foreign operators cannot engage in interstate commerce, no foreign aircraft is subject to property tax. Informal telephone calls to the San Mateo County Assessor's Office (San Francisco International Airport) and the Los Angeles County Assessor's Office (Los Angeles International Airport) confirmed that these counties do not assess foreign-owned aircraft.

MFH:fr

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October 21, 2002

Re: Reciprocal Taxation Exemption Agreement Between US and China – Air China Property Request No.

Dear Mr. :

This is in response to your August 28, 2002, letter to the San Mateo County Assessment Appeals Board Clerk, that you faxed to Ms. Kristine Cazadd on September 28, 2002, regarding the property tax status of Air China. As explained in detail below, Air China appears to qualify for a property tax exemption based on the 1982 *Agreement Between the Government of the United States of America and the Government of the People's Republic of China with respect to Mutual Exemption from Taxation of Transportation Income of Shipping and Air Transport Enterprises* ("Agreement")(copy enclosed).

In your letter you state that Air China is a division of the Central Government of the People's Republic of China. Revenue and Taxation Code section 5331 provides:

> Aircraft owned by the United States, by **any foreign government**, or by a consul or other official representative of any foreign government, are exempt from personal property taxation. [Emphasis added]

Section 5331 appears to provide a simple and clear answer to your inquiry if the aircraft are, in fact, owned by a foreign government and the aircraft otherwise qualify for the exemption.[1]

[1] Our limited review of the legislative history of AB 1568 (Stats. 1961, p. 3681) indicates that there are limitations on the definition of aircraft. Because of the limited facts provided we are unable to determine whether these limitations apply to aircraft owned by Air China.

In the event that the facts are not absolutely clear, we have provided a further analysis of the law applicable to reciprocal tax exemptions, which involve treaties and international agreements executed by the U.S. Government with a foreign nation.

Article I of the Agreement with the People's Republic of China provides:

> Income and profits of an enterprise of a Contracting State from the operation of Ships or aircraft in international traffic shall be taxable only in that Contracting State.

For the congressional hearings on the treaty, the Treasury Department prepared a *Technical Explanation of the Agreement Between the Government of the United States of America and the Government of the People's Republic of China with respect to Mutual Exemption from Taxation of Transportation Income of Shipping and Air Transport Enterprises Signed at Beijing on March 5, 1982* ("Treasury Explanation")(copy enclosed). Article I of the Treasure Explanation provides:

> In the case of the People's Republic of China, the tax exemption applies to all taxes on income and profits collected at the national level (whether in force at the time of signature or subsequently enacted), including local surcharges collected by the national government. In the case of the United States, the tax exemption covers the Federal income tax. However, it was understood that if any state or locality of the United States imposes tax on enterprises of the people's Republic of China on income and profits from the operation of ships or aircraft in international traffic, the People's Republic of China may impose any local surcharge on such income and profits of U.S. enterprises.

In determining the meaning of the language in an international treaty or agreement and its effect on domestic law such as local property tax law, a court of the United States is to some extent required to take into account domestic sources in the formation of an international agreement such as committee reports indicative of the meaning that the United States Senate has attached to an international agreement in cases where the agreement, as a matter of internal law, requires the assent of the Senate. (See *Scandinavian Airline System, Inc. v. County of Los Angeles* (1961) 56 Cal. 2d 11, 48)("*SAS v. LA County*"). The information from such committees with respect to treaties is equivalent to legislative history with respect to California laws.

Based on the explanation submitted, the Treasury Department was clearly concerned about retaliatory taxes. Also, their explanation demonstrates the complexities involved in negotiating treaties or agreements between two governments with different forms and a multiplicity of local governments.

While at first glance the wording of the Agreement appears to apply only to "taxes on income and profits," the application of similar phrases in income tax treaties and international agreements has been applied to property taxes by the courts. In *SAS v. LA County,* the California Supreme Court determined that Los Angeles County was barred by international treaty from imposing property taxes on aircraft. Several international treaties and agreements, each of which used different language, were before the Court. On their face some of these treaties and agreements included language similar to that in the Agreement and appeared to apply only to taxes on income and profits. The Court held that in each situation Los Angeles County was precluded from imposing property taxes.

The Court determined that the treaties and agreements regarding aircraft owned and registered in Sweden clearly eliminated the possibility of local property taxation. The Court believed that the express language and terms in the treaties and agreements with respect to the other airlines involved in the litigation were not enough on their face to invalidate the property tax assessments. However, the Court determined that prohibiting the imposition of property taxation on the aircraft in one treaty country and not another would be discriminatory and would interfere with the free flow of commerce which was one of the purposes of the treaty. The Court also expressed fear that retaliatory taxation would be inevitable. Accordingly, the Court affirmed the judgment that found the aircraft were not subject to property taxation.

The United States Supreme Court, in the landmark decision in *Japan Line, Ltd. v. County of Los Angeles* (1979) 441 U.S. 434, added requirements that the courts must consider in determining whether instrumentality's of foreign commerce could be taxed. Courts must consider, for example, whether there is a substantial risk of international multiple taxation and whether the tax prevents the federal government from speaking with one voice when regulating commercial relations with foreign governments. Although these issues deal more directly with the commerce clause, they have a significant bearing on the interpretation of tax treaty provisions.

As the California Supreme Court discussed in *SAS v. LA County* and the Treasury Department indicated in their Explanation of the Agreement, there is a strong possibility of a retaliatory tax by the People's Republic of China if counties in this state subject Air China's aircraft to property taxes. The counties in California could jeopardize one of the purposes of the Agreement and subject the aircraft of U.S. carriers to a retaliatory tax.

It is our opinion that the imposition of any property tax on aircraft and other property owned or leased by Air China, including possessory interests, is prohibited under the Agreement. The language of the Agreement and the court decisions broadly interpret the treaties and international agreements to exempt the airlines from property taxes. The facts, as we understand them, are very similar to those in *SAS v. LA County*. While the specific wording of the Agreement may appear to exempt only income and profits, the Agreement must be interpreted to include property taxation within the exemption. Imposing property taxes on Air China would likely result in a retaliatory tax by the People's Republic of China. Imposing property taxes on Air China, but not on other airlines, would be discriminatory. The ramifications of subjecting these aircraft to property taxation could have a significant impact on other states and would inhibit the federal government from speaking with one voice when regulating commercial relations with foreign governments.

Our opinion is consistent with a legal opinion from our office dated November 1, 1982, and annotated in the Property Tax Law Guide (Annotation 215.0020 Foreign-Owned Aircraft)(copies enclosed). While an annotated legal opinion does not have as great weight as a regulation, the courts give deference to an agency's interpretation. Among the factors that the courts consider in determining the weight given to annotations are the expertise of the agency in interpreting the statutory scheme, whether the position has been consistently maintained, and are of a long-standing duration. *Yamaha Corp. of America v. State Bd. Of Equalization* (1998) 19 Cal. 4th 1. The Board possesses expertise and specific legislative authority to interpret property taxes, and the Board interpretation has been consistently maintained for 20-years.

The views expressed in this letter are advisory in nature only; they represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or public entity. You may wish to contact the Assessor's Office for the to ascertain whether it is in agreement with the analysis and conclusions set forth herein.

Sincerely yours,

/s/ Paul A. Steinberg

Paul A. Steinberg
Senior Tax Counsel

Enclosures

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cc:

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